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COMPILATION OF THE FY 2000 ARMY WORKING
CAPITAL FUND FINANCIAL STATEMENTS

Report No. D-2001-177

August 31, 2001

Office of the Inspector General
Department of Defense

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| Abstract This report is the second in a series of audit reports relating to the audit of the FY 2000 Army Working Capital Fund Financial Statements. The first report was on our oversight of the Army Audit Agency audit of the FY 2000 Army Working Capital Fund Financial Statements. The Chief Financial Officers Act of 1990 requires the Inspector General, DoD, to audit the financial statements of DoD organizations in accordance with generally accepted Government auditing standards. The Inspector General, DoD, and the Army Audit Agency jointly performed the audit work at Defense Finance and Accounting Service Indianapolis. The Army Audit Agency disclaimed an opinion on the FY 2000 Army Working Capital Fund Financial Statements, and we endorsed the disclaimer. The FY 2000 Army Working Capital Fund Financial Statements reported assets of \$12.7 billion and liabilities of \$754 million. Net program costs for the Army Working Capital Fund were \$3.6 billion. | | |
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Acronyms

| | |
|------|--|
| AAA | Army Audit Agency |
| AFS | Audited Financial Statements |
| AR | Accounting Report |
| CFO | Chief Financial Officers |
| DDRS | Defense Departmental Reporting System |
| DFAS | Defense Finance and Accounting Service |
| WCF | Working Capital Fund |



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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August 31, 2001

**MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE**

**SUBJECT: Audit Report on Compilation of the FY 2000 Army Working Capital Fund
Financial Statements (Report No. D-2001-177)**

We are providing this report for review and comment. The Under Secretary of Defense (Comptroller) did not comment on the draft report. We considered the comments from the Director for Accounting, Defense Finance and Accounting Service, when preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. We request that the Under Secretary of Defense (Comptroller) provide comments to Recommendation 1. by October 1, 2001.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Richard B. Bird at (703) 604-9102 (DSN 664-9102) (rbird@dodig.osd.mil) or Mr. Carmelo G. Ventimiglia at (317) 510-3852 (DSN 699-3852) (cventimiglia@dodig.osd.mil). See Appendix C for the report distribution. The audit team members are listed inside the back cover.

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Office of the Inspector General, DoD

Report No. D-2001-177

(Project No. D2001FI-0035.001)

August 31, 2001

Compilation of the FY 2000 Army Working Capital Fund Financial Statements

Executive Summary

Introduction. This report is the second in a series of audit reports relating to the audit of the FY 2000 Army Working Capital Fund Financial Statements. The first report was on our oversight of the Army Audit Agency audit of the FY 2000 Army Working Capital Fund Financial Statements. The Chief Financial Officers Act of 1990 requires the Inspector General, DoD, to audit the financial statements of DoD organizations in accordance with generally accepted Government auditing standards. The Inspector General, DoD, and the Army Audit Agency jointly performed the audit work at Defense Finance and Accounting Service Indianapolis. The Army Audit Agency disclaimed an opinion on the FY 2000 Army Working Capital Fund Financial Statements, and we endorsed the disclaimer. The FY 2000 Army Working Capital Fund Financial Statements reported assets of \$12.7 billion and liabilities of \$754 million. Net program costs for the Army Working Capital Fund were \$3.6 billion.

Objectives. Our overall objective was to determine whether Defense Finance and Accounting Service Indianapolis consistently and accurately compiled financial data from field organizations and other sources for the FY 2000 Army Working Capital Fund Financial Statements. We also reviewed management controls related to the compilation of the financial statements.

Results. Defense Finance and Accounting Service Indianapolis (Sustaining Forces) improved the support for the adjusting accounting entries for the FY 2000 Army Working Capital Fund Financial Statements. However, approximately \$44 billion of the \$212.2 billion in adjusting accounting entries were not adequately supported and 76 adjusting accounting entries, valued at \$152.8 billion, were not promptly approved.

The Working Capital Fund Branch made \$25.3 billion in adjusting accounting entries without adequate support or audit trails. The Working Capital Fund Branch provided additional supporting documentation for \$24.9 billion of the \$25.3 billion in adjusting accounting entries. Thirty-five adjusting accounting entries, valued at \$110.7 billion, were not approved before the FY 2000 Army Working Capital Fund Financial Statements began to be compiled.

The Army/DoD Audited Financial Statements Branch did not adequately support \$18.7 billion in adjusting accounting entries made to the general ledger database

file. Further, 41 adjusting accounting entries, valued at \$42.1 billion, were not approved timely. As a result, the FY 2000 Army Working Capital Fund Financial Statements were likely materially misstated. For details of the audit results, see the Finding section of the report.

See Appendix A for details of the review of the management control program as it relates to the controls over the automated and manual processes used to compile the FY 2000 Army Working Capital Fund Financial Statements.

Summary of Recommendations. We recommend that the Under Secretary of Defense (Comptroller), in conjunction with the Director, Defense Finance and Accounting Service, incorporate the Defense Finance and Accounting Service guidance for the preparation of adjusting accounting entries in the DoD Financial Management Regulation. We recommend that the Director, Defense Finance and Accounting Service, hold the Director for each entity accountable for the proper preparation of adjusting accounting entries.

Management Comments. The Director for Accounting, Defense Finance and Accounting Service, stated that each site Director will be required to certify that the guidance for preparing adjusting accounting entries has been received and implemented. Further, Internal Review personnel will also perform operational reviews to ensure that the guidance has been implemented. The Director disagreed with how the report classified some adjusting accounting entries and portrayed the length of time taken to provide additional documentation to support journal vouchers. The Director stated that he did not believe that the unsupported adjusting accounting entries caused the financial statements to be materially misstated. The Under Secretary of Defense (Comptroller) did not comment on the need to incorporate the journal voucher guidance into the DoD Financial Management Regulation. A discussion of the management comments is in the Finding section of the report, and the complete text of the comments is in the Management Comments section.

Audit Response. The Defense Finance and Accounting Service comments on the recommendations were responsive. However, we maintain our position on how we classified the adjusting accounting entries and characterized the length of time taken to provide additional support for some journal vouchers. Defense Finance and Accounting Service Indianapolis (Sustaining Forces) made a total of 55 adjusting accounting entries to force one set of data to agree with another set of data without sufficient documentation or reconciliation. The voucher supporting each adjusting accounting entry did not contain or reference sufficient information to be considered adequately supported. It took from 9 to 36 workdays for the Working Capital Fund Branch to provide the Army Audit Agency with additional documentation on 7 of the 9 adjusting accounting entries that were eventually considered supported. We believe that the FY 2000 Army Working Capital Fund Financial Statements were subject to a high risk of material misstatement because \$44 billion in adjusting accounting entries lacked adequate support. We request that the Under Secretary of Defense (Comptroller) provide comments on the final report by October 1, 2001.

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Background

This report is the second in a series of audit reports on the FY 2000 Army Working Capital Fund (WCF) Financial Statements. The first report was on our oversight of the Army Audit Agency (AAA) audit of the FY 2000 Army WCF financial statements. This report summarizes the compilation process at Defense Finance and Accounting Service (DFAS) Indianapolis and reflects the audit work jointly performed by the Inspector General, DoD, and AAA.

Chief Financial Officers Act. The Chief Financial Officers (CFO) Act of 1990, as amended by the Federal Financial Management Act of 1994, requires DoD and other Government agencies to prepare financial statements. The Act also requires the Inspector General or an appointed external auditor to audit those financial statements in accordance with generally accepted Government auditing standards and other criteria that the Office of Management and Budget established.

Roles and Responsibilities. The Under Secretary of Defense (Comptroller), as the Chief Financial Officer, DoD, is responsible for overseeing the preparation of agency-wide financial statements. DoD Financial Management Regulation 7000.14-R, volume 6A, chapter 2, "Departmental Financial Reports Roles and Responsibilities," February 12, 1996, states that DFAS shall establish procedures to ensure that the process for preparing financial reports is consistent, timely, auditable, and controls are in place to provide for the accuracy of the reports. The regulation also requires DFAS to adequately support, and justify in writing, any adjustment to the official accounting records.

Role of DFAS Indianapolis (Sustaining Forces). Each month, field accounting entities that DFAS Indianapolis (Sustaining Forces) supports submit a general ledger trial balance directly to the Federal Financial System, a general ledger module of the Headquarters Accounting and Reporting System. They also submit monthly financial data on the status of appropriations to DFAS Indianapolis (Sustaining Forces). Two branches within DFAS Corporate Operations, DFAS Indianapolis (Sustaining Forces), prepare accounting reports and financial statements for the Army WCF. The WCF Branch prepares the monthly and year-end Defense WCF Accounting Report (AR) 1307 for the consolidated activity groups as well as the Army entity levels. The Army/DoD Audited Financial Statements (AFS) Branch maintains departmental accounting records and prepares the Army WCF financial statements.

Preparation of Accounting Reports. The WCF Branch prepares the monthly AR 1307 for each field accounting entity. Most accounting entities' general ledgers are transaction-driven; however, some financial data submitted to DFAS Indianapolis (Sustaining Forces) are not generated by an integrated transaction-driven general ledger system. The general ledger data in the AR 1307 database are supplemented with information from other sources, such as the Army Stock Fund Monthly Management Report/Statement 7, the Cost Accounting Budget general ledger, Reports on Budget Execution, and the Army WCF cash management report. The WCF Branch forces the general ledger data

in the AR 1307 database to agree with certified status of appropriations data, record field accounting adjusting entries, revalue inventory, record undistributed collections and disbursements, reconcile with the Department of the Treasury's records, and record assets. After the general ledger is supplemented with other information, the general ledger data are used to prepare the monthly AR 1307. Each field accounting entity reviews its AR 1307 for accuracy and completeness and certifies it. At the end of the fiscal year, the WCF Branch produces the year-end AR 1307.

Preparation of the Financial Statements. The DFAS Army/DoD AFS Branch is responsible for preparing the Army WCF financial statements. The year-end AR 1307 database becomes the beginning general ledger database file for the Army WCF financial statements. The DFAS Army/DoD AFS Branch makes adjusting accounting entries that are accumulated in the Journal Voucher database file in the Defense Departmental Reporting System (DDRS). This system was implemented DoD-wide in October 2000 for use in preparing the FY 2000 financial statements. Adjusting accounting entries are made for many reasons, including recording auditors' adjustments, making intra-agency eliminations, and meeting special reporting requirements. DFAS Indianapolis (Sustaining Forces) adds footnotes and supplementary schedules, and the Assistant Secretary of the Army (Financial Management and Comptroller) adds an overview section to the financial statements to create the Army WCF financial statements.

Army WCF Financial Statements. The FY 2000 Army WCF financial statements consist of the consolidated and consolidating balance sheets, consolidated and consolidating Statements of Net Cost, consolidated and consolidating Statements of Changes in Net Position, combined and combining Statements of Budgetary Resources, combined and combining Statements of Financing, supporting footnotes, and overview on the Army WCF financial statements. The FY 2000 Army WCF Consolidated Balance Sheet reported total assets of \$12.7 billion and total liabilities of \$754 million, and the consolidated Statement of Net Cost reported net program costs of \$3.6 billion.

Objectives

The overall audit objective was to determine whether DFAS Indianapolis (Sustaining Forces) consistently and accurately compiled financial data received from field organizations and other sources for the FY 2000 Army WCF financial statements. We also reviewed management controls as they related to the audit objective. See Appendix A for a discussion of the audit process and the DFAS Indianapolis (Sustaining Forces) management control program. See Appendix B for prior audit coverage related to the audit objective.

Accounting Entries to Financial Statements

DFAS Indianapolis (Sustaining Forces) improved the support for the adjusting accounting entries for the FY 2000 Army WCF financial statements. However, approximately \$44 billion of the \$212.2 billion in adjusting accounting entries were not adequately supported or were improper. Also, DFAS personnel did not promptly approve 76 adjusting accounting entries, valued at \$152.8 billion.

The WCF Branch made \$25.3 billion in adjusting accounting entries to the AR 1307 database without adequate support or audit trails. The year-end AR 1307 database was used as the beginning general ledger database file for the financial statements. The WCF Branch personnel were able to provide additional supporting documentation for \$24.9 billion of the \$25.3 billion in adjusting accounting entries. However, the documentation was not provided until as much as 36 workdays after the 5 workday grace period. Thirty-five adjusting accounting entries, valued at \$110.7 billion, were not approved before the AR 1307 was provided to the Army for certification and the FY 2000 Army WCF financial statements began to be compiled.

The DFAS Army/DoD AFS Branch did not adequately support \$18.7 billion in adjusting accounting entries made to the general ledger database file. Further, 41 adjusting accounting entries, valued at \$42.1 billion, were not approved timely.

Adjusting accounting entries were not adequately supported because DFAS Indianapolis (Sustaining Forces) did not completely follow established guidance for preparing adjusting accounting entries and DFAS guidance did not clearly state when the adjusting accounting entries were to be approved. As a result, the FY 2000 Army WCF financial statements were likely materially misstated.

Guidance for Supporting Accounting Entries

DFAS Arlington issued DFAS Memorandum, "Journal Voucher Guidance," August 2, 2000, to each DFAS organization responsible for compiling the FY 2000 financial statements. The guidance requires that each adjusting accounting entry be adequately documented and properly approved. The guidance identifies the required documentation for each type of adjusting accounting entry and who within the organization is to approve the adjusting accounting entries. The guidance also required that all supporting documentation be identified and made available not more than 5 workdays following the approval of the adjusting accounting entry. In August 2000, DFAS Indianapolis (Sustaining Forces) prepared a journal voucher handbook that identified how 35 types of common adjusting accounting entries were to be documented.

Adjusting Accounting Entries

DFAS Indianapolis (Sustaining Forces) improved the documentation supporting the adjusting accounting entries made in compiling the FY 2000 Army WCF financial statements. However, approximately \$44 billion of the \$212.2 billion in adjusting accounting entries made by the DFAS Indianapolis (Sustaining Forces) in compiling the FY 2000 Army WCF financial statements were not adequately supported. In Inspector General, DoD, Report No. D-2000-173, "Compilation of the FY 1999 Army Working Capital Fund Financial Statements," August 15, 2000, we reported that DFAS Indianapolis inadequately supported \$127.8 billion of the \$181.8 billion in adjusting accounting entries for the FY 1999 Army Working Capital Fund Financial Statements. The reduction in the dollar value of unsupported adjusting accounting entries from FY 1999 through FY 2000 can be attributed to a more concerted effort to follow the guidance in the DoD Financial Management Regulation and the supplemental DFAS guidance. Further improvements can be made if the WCF Branch and the DFAS Army/DoD AFS Branch follow established procedures and approving officials review the support for adjusting accounting entries in a more detailed and timely manner.

AR 1307 Adjusting Accounting Entries. The WCF Branch prepared 81 adjusting accounting entries, valued at \$167.5 billion, for the general ledger data in the AR 1307 database. Of the 81 adjusting accounting entries, 14 entries, valued at approximately \$25.3 billion, did not have adequate support to verify the accounting data or an adequate audit trail back to supporting adjusting accounting entries. From November 2000 through January 2001, AAA requested additional supporting documentation for the 14 adjusting accounting entries and received documentation for 9 of those adjusting accounting entries. After WCF Branch personnel provided the additional documentation for the unsupported adjusting accounting entries, AAA concluded, and we concurred, that 9 of 14 adjusting accounting entries, or about \$24.9 billion of the \$25.3 billion, were valid adjusting accounting entries. However, the additional supporting documentation was not provided to the auditors until as much as 36 workdays after the 5 workday grace period. The WCF Branch should have attached sufficient documentation to the adjusting accounting entries shortly after the entries were prepared. AAA determined that procedures for reviewing adjustments to the general ledger data in the AR 1307 database needed further improvement. AAA will make a recommendation that DFAS Indianapolis (Sustaining Forces) follow the requirements in DoD Financial Management Regulation 7000.14-R, volume 6A, "Reporting Policy and Procedures," and its own internal guidance for supporting adjusting accounting entries. Therefore, this report makes no recommendation concerning the entries.

Adjusting Accounting Entries to the General Ledger Database File. The DFAS Army/DoD AFS Branch did not follow established guidance for supporting the adjusting accounting entries made to the general ledger database file when compiling the FY 2000 Army WCF financial statements. The DFAS Army/DoD AFS Branch made 170 adjusting accounting entries in DDRS, valued at \$44.7 billion, in compiling the FY 2000 Army WCF financial statements. Of the 170 adjusting accounting entries, 63 adjusting accounting

entries, valued at \$18.7 billion, did not have documentary evidence to support the entries. We classified the 63 adjusting accounting entries into three different classifications. Table 1 shows the classifications.

| Table 1. Adjusting Accounting Entry Classifications | | |
|--|---|---|
| <u>Description of Deficiency</u> | <u>Number of Adjusting Accounting Entries</u> | <u>Value of Adjusting Accounting Entries (billions)</u> |
| Buyer-seller forced entries | 41 | \$14.4 |
| Entries to correct discrepancies between data sources | 14 | .9 |
| Other unsupported or improper entries | <u>8</u> | <u>3.4</u> |
| Total | 63 | \$18.7 |

Entries to Correct Different Sources of Accounting Data. The DFAS Army/DoD AFS Branch prepared 41 adjusting accounting entries, valued at approximately \$14.4 billion, to force intragovernmental transactions between trading partners to agree. DFAS Army/DoD AFS Branch personnel forced buyers' transaction data to agree with sellers' transaction data without reconciling the differences because the Army WCF's systems did not capture trading partner data at the transaction level. The Journal Voucher Guidance states that procedures to use information from the sellers were developed due to systems limitations that prevent the identification of buyer-side transactions by specific trading partner. DoD plans to develop long-term systems improvements that will include sufficient up-front edits and controls to eliminate the need for reconciliations. The DFAS Army/DoD AFS Branch also prepared 14 adjusting accounting entries, valued at approximately \$0.9 billion, to force one set of accounting data or financial statement to agree with another set of accounting data or financial statement without sufficient documentation or reconciliation. None of the 55 adjusting accounting entries were supported because DFAS Army/DoD AFS Branch personnel did not reconcile the differences between the two data sources to determine which one was correct. If differences among conflicting sources of accounting data are not reconciled, DFAS has no assurance that it is using the most accurate accounting data for financial reporting for the Army.

Other Unsupported Entries. The DFAS Army/DoD AFS Branch also prepared eight adjusting accounting entries, valued at approximately \$3.4 billion, which were not adequately documented to support the validity and

amount of the accounting entries. For example, journal voucher identification number AT97A01AA3-6, valued at \$12.5 million, did not explain why the correction was needed or have supporting documentation as to why the original entry needed to be reversed. The Chief, DFAS Army/DoD AFS Branch, had previously reviewed and approved the adjusting accounting entry. In addition, higher level approving officials did not return adjusting accounting entries valued at \$100 million or more for additional support because they were not reviewed and approved in a timely manner. For example, journal voucher identification number AT97A01AC-23, valued at \$3.3 billion, was approved, but we determined that it was not adequately supported by documentation that DFAS guidance required. DFAS should fully implement the Journal Voucher Guidance on the preparation of adjusting accounting entry to ensure that all changes to accounting data are properly documented. Further, the Under Secretary of Defense (Comptroller) should incorporate the guidance in the DoD Financial Management Regulation.

Approval of Adjusting Accounting Entries

Approving officials did not always promptly review and approve adjusting accounting entries. Seventy-six adjusting accounting entries, valued at approximately \$152.8 billion, were not approved in a timely manner. The prompt review and approval of adjusting accounting entries by approving officials is necessary to ensure the enforcement of the DFAS guidance on the preparation of adjusting accounting entries. Officials reviewing and approving adjusting accounting entries after they were entered in DDRS and reflected in official accounting reports and financial statements would be reluctant to return the adjusting accounting entries for additional support. The Director, DFAS, should hold the Director for each accounting entity accountable for the proper preparation of adjusting accounting entries to ensure that all changes to accounting data are properly documented.

WCF Branch. Of the 81 adjusting accounting entries made by the WCF Branch, 35 entries, valued at \$110.7 billion, were not approved by the appropriate approving official when the AR 1307 was provided to the Army for certification and to the DFAS Army/DoD AFS Branch for use in compiling the FY 2000 Army WCF financial statements. The DFAS guidance identified approval levels based on the dollar values of the adjusting accounting entries. Increasingly higher levels of management were to approve the adjusting accounting entries as the dollar value of the adjustments increased. The appropriate approving officials eventually approved the 35 adjusting accounting entries. However, some of the adjusting accounting entries were not approved until after the AR 1307 had been provided to the Army for certification and the DFAS Army/DoD AFS Branch had begun making adjusting accounting entries to DDRS in compiling the FY 2000 Army WCF financial statements. Further, in some instances, when approving officials eventually made their reviews, they approved the adjusting accounting entries without adequately reviewing the accounting entries and supporting documentation. The lack of documentation supporting the adjusting accounting entries should have been, but was not, detected by the approving officials before the auditors were provided the adjusting accounting entries.

DFAS Army/DoD AFS Branch. The Chief, DFAS Army/DoD AFS Branch, promptly approved the 128 adjusting accounting entries that were individually valued at under \$100 million. However, 41 of the 42 adjusting accounting entries that were individually valued at \$100 million or more were not approved by the appropriate approving official in a timely manner. The 41 adjusting accounting entries were not approved before the issuance of version 3 of the FY 2000 Army WCF financial statements (January 23, 2001) even though 35 of the 41 accounting entries were made before the issuance of the version 2 financial statements (December 19, 2000). For example, journal voucher identification number AT97AO1AC-23, valued at \$3.3 billion, was prepared on November 26, 2000, but was not approved by the appropriate approving official until 74 days later on February 7, 2001. The 41 adjusting accounting entries had a combined value of approximately \$42.1 billion. Table 2 shows the approval levels, the number of adjusting accounting entries prepared for each version of the financial statements, and whether or not the adjusting accounting entries were approved before issuing each version of the financial statements.

Table 2. Approval of Adjusting Accounting Entries for Financial Statements

| <u>Approval Level</u> | <u>Number of Adjusting Accounting Entries</u> | | <u>Adjusting Accounting Entries Approved Before Issuance</u> | |
|---|---|------------------|--|------------------|
| | <u>Version 2</u> | <u>Version 3</u> | <u>Version 2</u> | <u>Version 3</u> |
| \$100 million to \$500 million (Assistant Deputy Director, DFAS Corporate Operations) | 23 | 6 | No* | No |
| \$500 million to \$1 billion (Director, DFAS Corporate Operations) | 3 | 0 | No | No |
| More than \$1 billion (Director, DFAS Indianapolis [Sustaining Forces]) | <u>10</u> | <u>0</u> | No | No |
| Total | 36 | 6 | | |

*One of the 23 adjusting accounting entries had been properly approved before the issuance of version 2.

Journal Voucher Guidance. The DFAS guidance did not clearly state when the adjusting accounting entries were to be approved. DFAS Indianapolis (Sustaining Forces) personnel stated that the approving official had until the time the financial statements were published to approve the adjusting accounting

entries. The FY 2000 Army WCF financial statements were published on February 15, 2001. AAA will make a recommendation that the adjusting accounting entries prepared by the WCF Branch be approved before the AR 1307 is provided to the Army for certification and to the DFAS Army/DoD AFS Branch for use in compiling the FY 2000 Army WCF financial statements. The Inspector General, DoD, Report No. D-2001-165, "Defense Departmental Reporting System-Audited Financial Statements," August 3, 2001, recommended that the Audited Financial Statement module of DDRS be modified to contain proper internal controls that distinguish signature codes in the adjusting accounting entry approval role and associate the signature codes with the proper approval levels.

Conclusion

DFAS Indianapolis (Sustaining Forces) made progress in improving the support for the adjusting accounting entries made for the FY 2000 Army WCF financial statements. However, DFAS Indianapolis (Sustaining Forces) personnel did not adequately support \$44 billion of the \$212.2 billion in adjusting accounting entries in compiling the FY 2000 Army WCF financial statements. Although WCF Branch personnel were able to eventually provide the additional documentation for 9 adjusting accounting entries, valued at about \$24.9 billion, further improvements are necessary to adequately support all adjustments before they are provided to the auditors and reflected in official accounting reports and financial statements. Of the 251 adjusting accounting entries prepared in support of the FY 2000 Army WCF financial statements, 76 entries, valued at about \$152.8 billion, were not approved in a timely manner. DFAS Indianapolis (Sustaining Forces) should fully implement the procedures in the Journal Voucher Guidance and handbook. Because of the lack of appropriate management controls, the FY 2000 Army WCF financial statements were likely materially misstated.

Management Comments on the Finding and Audit Response

DFAS Comments. The Director for Accounting, DFAS, disagreed with how the audit classified some journal vouchers. The Director stated that many of the adjusting accounting entries were not forced adjustments. The Director took exception to adjusting accounting entries for revaluing inventory, recording property, posting undistributed amounts, and adjusting certain line items on the Statement of Financing. The Director disagreed with classifying some of the adjusting accounting entries prepared by the WCF Branch as unsupported. The Director disagreed with the length of time it took for WCF Branch personnel to provide the additional documentation needed to support some of the journal vouchers that AAA ultimately concluded were valid adjusting accounting entries. The Director also stated that he did not believe that the unsupported adjusting accounting entries caused the FY 2000 Army WCF financial statements to be materially misstated.

Audit Response. We did not classify the adjusting accounting entries for revaluing inventory, recording property, and posting undistributed amounts as forced adjustments. However, DFAS Indianapolis (Sustaining Forces) personnel did not follow established guidance in supporting the forced adjustments they made. DFAS Indianapolis (Sustaining Forces) made a total of 55 adjusting accounting entries to force one set of data to agree with another set of data without sufficient documentation or reconciliation. It also took from 9 to 36 workdays for the WCF Branch to provide AAA with additional documentation on 7 of the 9 adjusting accounting entries that were ultimately considered supported. The voucher supporting each type of adjusting accounting entry must contain or reference sufficient information to be considered adequately supported. The FY 2000 AWCF financial statements were subject to a high risk of material misstatement because \$44 billion in adjusting accounting entries lacked adequate support.

Recommendations and Management Comments

1. We recommend that the Under Secretary of Defense (Comptroller), in conjunction with the Director, Defense Finance and Accounting Service, incorporate the guidance for the preparation of adjusting accounting entries in the DoD Financial Management Regulation.

Management Comments. Although not required to comment, the Director for Accounting, DFAS, stated that DFAS will work with the Under Secretary of Defense (Comptroller) to incorporate the journal voucher guidance into the DoD Financial Management Regulation.

Audit Response. The Under Secretary of Defense (Comptroller) did not comment on a draft of this report. Therefore, we request that the Under Secretary of Defense (Comptroller) provide comments on the final report.

2. We recommend that the Director, Defense Finance and Accounting Service, hold the Director for each accounting entity accountable for the proper preparation of adjusting accounting entries to ensure that all changes to accounting data are properly documented.

Management Comments. The Director for Accounting, DFAS, concurred stating that the Director for each accounting entity will be held accountable for the proper preparation of adjusting accounting entries. Further, each site Director will be required to certify that the guidance for preparing adjusting accounting entries has been received and implemented. DFAS Internal Review personnel will also perform operational reviews to ensure that the guidance has been implemented.

Appendix A. Audit Process

Scope

Audit Work Performed. Our audit work was limited to the examination of the processes, procedures, and management controls followed by the WCF Branch and the DFAS Army/DoD AFS Branch for compiling financial data from field entities and other sources into the FY 2000 Army WCF financial statements. The FY 2000 Army WCF financial statements reported total assets of \$12.7 billion, total liabilities of \$754 million, and net program costs of \$3.6 billion.

Limitations to Audit Scope. We did not examine the accuracy of data that Army field accounting entities or other sources submitted nor did we attempt to reconcile data with subsidiary records because of the lack of audit trails and support for accounting adjustments.

Audit of the FY 2000 Army WCF Financial Statements. The Inspector General, DoD, delegated the audit of the FY 2000 Army WCF financial statements to AAA. The AAA performed work at Army field entities, where it examined a limited number of accounting transactions of original entry. The Inspector General, DoD, and the AAA auditors jointly performed audit work on adjusting accounting entries made to the AR 1307 database and the general ledger database file. The AAA disclaimed an opinion on the FY 2000 Army WCF financial statements, and we endorsed the disclaimer.

DoD-Wide Corporate-Level Government Performance and Results Act Coverage. In response to the Government Performance and Results Act, the Secretary of Defense annually establishes DoD-wide corporate-level goals, subordinate performance goals, and performance measures. This report pertains to achievement of the following corporate-level goal, subordinate performance goal, and performance measure.

FY 2001 DoD Corporate-Level Goal 2: Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. **(01-DoD-02)**

FY 2001 Subordinate Performance Goal 2.5: Improve DoD financial and information management. **(01-DoD-2.5)**

FY 2001 Performance Measure 2.5.2: Achieve unqualified opinions on financial statements. **(01-DoD-2.5.2)**

DoD Functional Area Reform Objectives and Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the following functional area objective and goal.

Financial Management Area. Objective: Strengthen internal controls.
Goal: Improve compliance with the Federal Managers' Financial Integrity Act. (FM-5.3)

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in the DoD. This report provides coverage of the Defense Financial Management high-risk area.

Methodology

Audit Work Performed. We oversaw the AAA review of the adjusting accounting entries made by the WCF Branch to the AR 1307 database and the passing of the AR 1307 database to the DFAS Army/DoD AFS Branch. Our audit work focused on the adjusting accounting entry process to correct the accounting data from the field. We examined the adjusting accounting entries to determine whether the DFAS Army/DoD AFS Branch had support for the changes to the general ledger accounting data from the field entities and whether DFAS Army/DoD AFS Branch had appropriate approval. We also reviewed accounting policy and procedures in DoD Financial Management Regulation 7000.14-R, volume 6A, chapter 2, "Departmental Financial Reports Roles and Responsibilities," February 12, 1996. We compared the support for the adjusting accounting entries to the guidance in DFAS Memorandum, "Journal Voucher Guidance," August 2, 2000.

Use of Computer-Processed Data. We did not rely on the computer-processed data used to prepare the FY 2000 Army WCF financial statements because the DoD accounting and related systems were unreliable. The unreliable computer-processed data used in preparing the financial statements and this report were the only financial data available. AAA and the Inspector General, DoD, reviewed a total of 251 adjusting accounting entries, valued at \$212.2 billion. The WCF Branch made 81 adjusting accounting entries, valued at \$167.5 billion, to the AR 1307 database file. The DFAS Army/DoD AFS Branch made 170 adjusting accounting entries, valued at \$44.7 billion, to the general ledger database file.

Audit Type, Period, and Standards. We performed this financial-related audit at DFAS Indianapolis (Sustaining Forces) from October 2000 through March 2001 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD. We did our work in accordance with generally accepted Government auditing standards except that we were unable to obtain an opinion on our system of quality control. The most recent external quality control review was withdrawn on March 15, 2001, and we will undergo a new review.

Contact During the Audit. We visited or contacted individuals and organizations in the DoD audit and accounting community. Further details are available on request.

Management Control Program Review

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides a reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of the Review of the Management Control Program. We evaluated the adequacy of management controls over DFAS Indianapolis (Sustaining Forces) processes and procedures for compiling financial data from field organizations and other sources for preparing the FY 2000 Army WCF financial statements.

Adequacy of Management Controls. We identified a material management control weakness, as defined by DoD Instruction 5010.40, in procedures used by DFAS Indianapolis (Sustaining Forces) for compiling the FY 2000 Army WCF financial statements. Management controls were not adequate to ensure that adjusting accounting entries were adequately documented and properly approved before the Army WCF financial statements were released. Recommendation 2., if implemented, will improve controls over adjusting accounting entries. A copy of the report will be provided to the senior official responsible for management controls for DFAS Indianapolis (Sustaining Forces).

Adequacy of Management's Self-Evaluation. DFAS officials identified financial statement reporting as an assessable unit but did not perform an evaluation because no evaluations were scheduled to be completed until FY 2001.

Appendix B. Prior Coverage

Inspector General, DoD

Inspector General, DoD, Report No. D-2001-063, "Oversight of the Army Audit Agency Audit of the FY 2000 Army Working Capital Fund Financial Statements," February 28, 2001

Inspector General, DoD, Report No. D-2000-173, "Compilation of the FY 1999 Army Working Capital Fund Financial Statements," August 15, 2000

Inspector General, DoD, Report No. 99-258, "Compilation of the FY 1998 Army Working Capital Fund Financial Statements," September 23, 1999

Inspector General, DoD, Report No. 98-216, "Compilation of the FY 1997 Army Working Capital Fund Financial Statements," September 29, 1998

Army Audit Agency

Army Audit Agency Report No. AA 01-443, "Compilation of Army Working Capital Fund FY 00 1307 Accounting Report," August 31, 2001

Army Audit Agency Report No. AA 00-399, "Compilation of Selected Army Working Capital Fund FY 99 Financial Statements," September 25, 2000

Army Audit Agency Report No. AA 99-161, "Army Working Capital Fund Principal Financial Statements for Fiscal Year 1998: Report on Internal Controls and Compliance With Laws and Regulations," February 12, 1999

Army Audit Agency Report No. AA 99-137, "Army Working Capital Fund Principal Financial Statements for Fiscal Year 1997: Accounting Support," November 25, 1998

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Director for Accounting Policy
Deputy Comptroller (Program/Budget)

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller)
Auditor General, Department of the Army

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service Indianapolis (Sustaining Forces)

Non-Defense Federal Organization

Office of Management and Budget

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform
House Subcommittee on Technology and Procurement Policy, Committee on Government Reform

Defense Finance and Accounting Service Comments



DFAS-DAS

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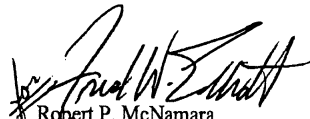


JUN 13 2001

MEMORANDUM FOR DIRECTOR, FINANCE AND ACCOUNTING DIRECTORATE,
OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF
DEFENSE

SUBJECT: Audit Report on Compilation of the FY 2000 Army Working Capital Fund Financial
Statements (Project No. D2001FI-0035.001)

Our response to the subject audit is attached. The point of contact is Mr. David Arvin,
(703) 607-2857 or DSN 327-2857.


Robert P. McNamara
Director for Accounting

Attachment:
As stated

cc:
DFAS-DDI
DFAS-AX/IS

**DFAS Comments on Audit Report on Compilation of the FY 2000 Army
Working Capital Fund Financial Statements (Project No. D2001FI-0035.001)**

Specific Comments

Page 1, Preparation of Accounting Reports. We disagree that many of our general ledger adjustments are "forced." For example, the revaluation of inventory is done as required by the Department of Defense Financial Management Regulation (DoDFMR) 7000.14, and the assets are reported on field general ledgers, based on interfaces from the property systems. The Working Capital Fund (WCF) Branch also posts all adjustments necessary to reflect the actual Treasury balances on the monthly accounting reports as required by the DoDFMR, such as undistributed disbursements/collections and other Treasury balances. DFAS does not believe any of the adjustments should be considered "forced" adjustments.

Page 3, Accounting Entries to Financial Statements. We disagree with the statement in the second paragraph, stating that the WCF Branch made \$25.3 billion in adjusting entries without adequate support or audit trails. The bulk (\$24.9 billion) of these were classified as unsupported, because a WCF Branch oversight omitted one page of a memorandum on several vouchers. Since other vouchers had been previously prepared citing the same memorandum and containing the missing memorandum page, this error should be considered when determining the value of unsupported entries, especially in light of the fact that we promptly provided documentation to the Army Audit Agency's inquiry when we were notified of the problem. We disagree with the context of the statement in this paragraph concerning the 36 workdays before documentation was provided to the auditors. We reiterate that the "additional supporting documentation" amounts to one page of an included memorandum. It took 36 workdays from the date of the journal voucher to provide the documentation because we were unaware that the page was missing, but we provided the auditors copies of all missing documentation within 24 to 48 hours of their notification of a problem with a voucher.

We disagree with the statement in the fourth paragraph, "As a result, the FY 2000 Army WCF Financial Statements were likely materially misstated." We do not believe the misstatement from the journal voucher (JV) adjustments can be quantified. JV adjustments to financial data are made only when there is reason to believe the entry will make the statements more materially accurate. Therefore, we do not believe these adjustments caused the statements to be materially misstated.

Page 4, Adjusting Accounting Entries/AR 1307 Adjusting Accounting Entries. We disagree with the context of the statement in this paragraph concerning the 36 workdays before documentation was provided to the auditors. We reiterate that the "additional supporting documentation" amounts to one page of an included memorandum. It took 36 workdays from the date of the journal voucher to provide the documentation because we were unaware that the page was missing, but we provided the auditors copies of all missing documentation within 24 to 48 hours of their notification of a problem with a voucher.

Page 5, Entries to Correct Different Sources of Accounting Data. The entries in question were made to balance the Statement of Financing. The accounting systems currently in use do not produce data in sufficient detail to produce a Statement of Financing. As a result, data must be adjusted by information derived from other statements to bring the Statement of Financing into balance. Data from the other statements were considered to be more accurate than the Statement of Financing because the Balance Sheet, Statement of Net Cost, and the Statement of Changes in Net Position supported each other. These data are also considered to be more correct than data used to produce the Statement of Financing, which was known to contain data of insufficient detail.

Response to Recommendation

Recommendation 1. We recommend that the Under Secretary of Defense (Comptroller), in conjunction with the Director, Defense Finance and Accounting Service, incorporate the guidance for the preparation of journal vouchers in the DoD Financial Management Regulation.

Management Comments. Concur in principle. DFAS has provided draft input to the Office of the Under Secretary of Defense (Comptroller) OUSD (C). We are working with OUSD (C) to implement the current DFAS JV guidance into the DoDFMR. However, final responsibility for the recommended action rests with the OUSD (C). We consider our action, with respect to this audit recommendation, to be complete.

Recommendation 2. We recommend that the Director, Defense Finance and Accounting Service, hold the Director for each entity accountable for the proper preparation of journal vouchers to ensure that all accounting data are properly documented.

Management Comments. Concur. DFAS is currently working with OUSD (C) to incorporate the current DFAS JV guidance into the DoDFMR. Under the DFAS Certification Program, each site director must certify that the new policy/procedural guidance has been received and must certify that the policy/guidance has been implemented. Then, DFAS Internal Review personnel will perform operational reviews at each site to validate whether the policies have been implemented. This is the method by which we will hold ourselves accountable for the proper preparation and documentation of journal vouchers.

Estimated Completion Date: December 31, 2001.

Audit Team Members

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, prepared this report. Personnel of the Office of the Inspector General, DoD, who contributed to the report are listed below.

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